

Internal Revenue Service

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March 25, 2010

LEGEND

Distributing =

State X =

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Shareholder 4 =

Shareholder 5 =

Shareholder 6 =

Shareholder 7 =

Business A =

Business B =

a =

b =

c =

d =

e =

f =

g =

Date 1 =

Date 2 =

Dear :

This letter responds to your January 15, 2010 request, submitted by your authorized representative, for rulings on certain federal income tax consequences of the Proposed Transaction (described below). The information provided in that request and in later correspondence is summarized below.

The rulings contained in this letter are based upon facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the Proposed Transaction: (i) satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) is being used principally as a device for the distribution of the earnings and profits of the distributing corporation or the controlled corporation or both (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or

greater interest in the distributing corporation or the controlled corporation (see section 355(e) and Treas. Reg. § 1.355-7).

STATEMENT OF FACTS

Distributing is a State X corporation that was organized as a subchapter C corporation on Date 1. On Date 2, which is within the last 10 years, Distributing elected to be treated as a subchapter S corporation for federal income tax purposes. Distributing has a shares of voting common stock issued and outstanding. Shareholders 1 through 5 (collectively, the “Group A Shareholders”) together own b shares of Distributing stock, which equals approximately c%. Shareholders 6 and 7 (collectively, the “Group B Shareholders”) own d and e shares, respectively, of Distributing stock, which collectively equals approximately f%.

Distributing is engaged in Business A and Business B. Distributing has submitted financial information indicating that Business A and Business B each have had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

PROPOSED TRANSACTION

For what are represented to be valid business reasons, Distributing has proposed the following transaction (the “Proposed Transaction”):

- (i) Distributing will form Controlled, which will have one class of voting common stock authorized.
- (ii) Distributing will transfer all of the assets related to Business B to Controlled in exchange for g shares of Controlled common stock, which will be 100 percent of Controlled’s outstanding stock, and the assumption by Controlled of all liabilities related to Business B (the “Contribution”).
- (iii) Immediately after the Contribution, Distributing will distribute all of the Controlled stock to the Group B Shareholders (d shares to Shareholder 6 and e shares to Shareholder 7) in exchange for all of their Distributing stock (the “Distribution”).

Immediately after the Distribution, Controlled will elect to be treated as a subchapter S corporation for federal income tax purposes.

REPRESENTATIONS

Distributing makes the following representations regarding the Proposed Transaction:

- (a) The fair market value of the Controlled stock to be received by each Group B Shareholder will be approximately equal to the fair market value of the Distributing stock surrendered by each Group B Shareholder in the Distribution.
- (b) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.
- (c) The five years of financial information submitted on behalf of Business A is representative of the present operations of the business, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) The five years of financial information submitted on behalf of Business B is representative of the present operations of the business, and with regard to such business, there have been no substantial operational changes since the date of the last financial statements submitted.
- (e) Distributing neither acquired Business A nor acquired control of an entity conducting Business A during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Throughout the five-year period ending on the date of the Distribution, Distributing will have been the principal owner of the goodwill and significant assets of Business A, and it will continue to be the principal owner following the Distribution.
- (f) Distributing neither acquired Business B nor acquired control of an entity conducting Business B during the five-year period ending on the date of the Distribution in a transaction in which gain or loss was recognized (or treated as recognized) in whole or in part. Throughout the five-year period ending on the date of the Distribution, Distributing will have been the principal owner of the goodwill and significant assets of Business B, and Controlled will be the principal owner following the Distribution.
- (g) Following the Proposed Transaction, Distributing and Controlled will each continue the active conduct of its business, independently and with its separate employees.

- (h) The Distribution is carried out for the following corporate business purposes: to allow each group of shareholders to own and manage its respective business based upon its own specific interests, to restrict its investment and devote its attention to its respective business, to operate its respective business independently and as it sees fit, to devote its undivided attention to its respective business, and to apply a consistent business strategy to its respective business. The Distribution is motivated, in whole or substantial part, by one or more of these corporate business purposes.
- (i) The Proposed Transaction is not used principally as a device for the distribution of earnings and profits of Distributing or Controlled or both.
- (j) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution.
- (k) For purposes of section 355(d), immediately after the Distribution, no person (determined after applying section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution, or (ii) attributable to distributions on Distributing stock that were acquired by purchase (as defined in section 355(d)(5) and (8)) during the five-year period (determined after applying section 355(d)(6)) ending on the date of the Distribution
- (l) The total adjusted basis of the assets that will be transferred to Controlled in the Contribution will equal or exceed the sum of (i) the total liabilities assumed (within the meaning of section 357(d)) by Controlled and (ii) the total amount of any money and the fair market value of any other property (within the meaning of section 361(b)) received by Distributing from Controlled and transferred to Distributing's shareholders or creditors pursuant to the plan of reorganization.
- (m) The total fair market value of the assets transferred to Controlled in the Contribution will exceed the sum of (i) the amount of any liabilities assumed (within the meaning of section 357(d)) by Controlled in connection with the exchange, (ii) the amount of any liabilities owed to Controlled by Distributing

- that are discharged or extinguished in connection with the exchange, and (iii) the amount of any cash and the fair market value of any other property (other than stock and securities permitted to be received under section 361(a) without the recognition of gain) received by Distributing in connection with the exchange. The fair market value of the assets of Controlled will exceed the amount of its liabilities immediately after the exchange.
- (n) The liabilities assumed (within the meaning of section 357(d)) by Controlled in the Contribution were incurred in the ordinary course of business and are associated with the assets being transferred.
 - (o) The income tax liability for the taxable year in which investment credit property (including any building to which section 47(d) applies) is transferred will be adjusted pursuant to section 50(a)(1) or (a)(2) (or section 47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of the property.
 - (p) Distributing neither accumulated its receivable nor made extraordinary payment of its payables in anticipation of the transaction.
 - (q) No income items, including accounts receivable, or any item resulting from a sale, exchange, or disposition of property that would have resulted in income to Distributing and no items of expense will be transferred to Controlled if Distributing has earned the right to receive the income or could claim a deduction for the expense under the accrual or similar method of accounting.
 - (r) Distributing and Controlled and their respective shareholders will each pay their own expenses, if any, incurred in connection with the transaction.
 - (s) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the Distribution.
 - (t) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
 - (u) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv).
 - (v) The Distribution is not part of a plan or series of related transactions (within the meaning of Treas. Reg. § 1.355-7) pursuant to which one or more persons will acquire, directly or indirectly, stock representing a 50-percent or greater interest (within the meaning of section 355(d)(4)) in Distributing or Controlled.

- (w) Immediately after the transaction either (1) no person will hold a 50-percent or greater interest (within the meaning of section 355(g)(3)) in the stock of Distributing or Controlled who did not hold such an investment immediately before the transaction, or (2) neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of section 355(g)(2)).
- (x) Effective Date 2, Distributing made an election under section 1362(a) to be a subchapter S corporation (within the meaning of section 1361(a)) and Distributing has continued to be a subchapter S corporation since Date 2 (within the meaning of section 1361(a)).
- (y) Controlled will elect to be treated as a subchapter S corporation, effective immediately after the Distribution.

RULINGS

Based solely on the information and representations submitted, we rule as follows on the Proposed Transaction:

- (1) The Contribution, together with the Distribution, will qualify as a reorganization within the meaning of section 368(a)(1)(D). Distributing and Controlled will each be “a party to a reorganization” within the meaning of section 368(b).
- (2) No gain or loss will be recognized by Distributing on the Contribution (sections 357(a) and 361(a)).
- (3) No gain or loss will be recognized by Controlled on the Contribution (section 1032(a)).
- (4) Controlled’s basis in each asset received from Distributing in the Contribution will equal the basis of such asset in the hands of Distributing immediately before the Contribution (section 362(b)).
- (5) Controlled’s holding period in each asset received from Distributing in the Contribution will include the period during which Distributing held such asset (section 1223(2)).
- (6) No gain or loss will be recognized by Distributing on the distribution of the Controlled stock in the Distribution (section 361(c)(1)).

- (7) No gain or loss will be recognized by the Group B Shareholders (and they will not otherwise include any amount in income) upon receipt of the Controlled stock in exchange for shares of their Distributing stock in the Distribution (section 355(a)(1)).
- (8) The aggregate basis of the Controlled stock received by each Group B Shareholder in the Distribution (including any fractional interest in Controlled stock to which the shareholder may be entitled) will be the same as the shareholder's aggregate basis in the Distributing stock surrendered in exchange therefor, allocated in the manner described in Treas. Reg. § 1.358-2(a)(2) (sections 358(a)(1) and (b)(2)).
- (9) The holding period of the Controlled stock received by each Group B Shareholder in the Distribution will include the holding period of the Distributing stock surrendered in exchange therefor, provided that the Distributing stock is held as a capital asset on the date of the Distribution (section 1223(1)).
- (10) The earnings and profits of Distributing, if any, will be allocated between Distributing and Controlled in accordance with section 312(h) and Treas. Reg. § 1.312-10(a).
- (11) Controlled will be subject to section 1374 with respect to any asset transferred to Controlled from Distributing in the Contribution to the same extent that Distributing was subject to section 1374 with respect to such asset. For purposes of section 1374, Controlled's recognition period will be reduced by the portion of Distributing's recognition period that expires prior to the Contribution (section 1374(d)(8) and Ann. 86-128, 1986-51 I.R.B. 22).
- (12) Distributing's momentary ownership of the stock of Controlled, as part of the reorganization under section 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under section 1361(b)(1)(B). If Controlled otherwise meets the requirements of a small business corporation under section 1361, Controlled will be eligible to elect to be a subchapter S corporation under section 1362(a) for its first taxable year.

CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax treatment of the Proposed Transaction under other provisions of the Code or the regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. In particular, no opinion is expressed regarding:

- (i) Whether the Distribution satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b);
- (ii) Whether the Distribution is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both;
- (iii) Whether the Proposed Transaction is part of a plan (or series of related transactions) under section 355(e)(2)(A)(ii); and
- (iv) Whether Distributing or Controlled otherwise meets the requirements of a small business corporation under section 1361.

PROCEDURAL STATEMENTS

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Frances L. Kelly
Assistant to the Branch Chief, Branch 2
Office of Associate Chief Counsel (Corporate)

cc: